



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
RAY R. AND NELLIE A. REEVES)

Appearances:

For Appellants: James M. Murphy
Attorney at Law

For Respondent: David M. Hinman
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Ray R. and Nellie A. Reeves against proposed assessments of additional personal income tax in the amounts of **\$3,027.00, \$2,510.00, and \$38,123.30** for the years 1970, 1971, and 1972, respectively.

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During 1970, 1971, and 1972, while residents of Nevada, appellants received certain payments from Reeves Rubber, Inc., "California **corporation**. The issue presented by this appeal is whether such payments are subject to the California personal income tax.

'Prior to 1958, Ray R. Reeves (hereinafter appellant) was an officer and major shareholder of Reeves Rubber, Inc. On December 8, 1958, in settlement of litigation pending between appellant and the corporation, the parties executed a settlement agreement. Relevant portions of the agreement are set forth below:

II. Employment and Rent

A. **The corporation** agrees to continue to employ Ray R. Reeves, and to employ Nellie A. Reeves and to rent from them certain real property owned by them, all on the following terms and conditions.

1. The corporation shall pay in the aggregate as and for said salaries, rent, or retirement pay, the sum of **\$5,450.00** per month, commencing on January 1, 1959 and continuing on the 1st day of each and every month thereafter for and during the life of Ray R. **Reeves....**

* * *

4. Reeves shall perform and render such advisory and consultive services as may from time to time be requested by the Board of Directors.

* * *

D. The parties shall also. **..(2)** execute and deliver. **..(b)** A covenant stating that the corporation shall have the right to use the name Reeves Rubber, Inc., and that Reeves. **..will** not carry on, directly, or indirectly, a business similar to that of the corporation. **..in** the seven southern counties of California, so long as the corporation is in business. **..(d)** Any and all patent and patent rights, trade formulas and technical information used or useful in the business of the corporation. **..shall** be

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and remain the property of the corporation, and, if required, a transfer and assignment thereof shall be made to the corporation. (Emphasis added.)

During the period from January 1959 through November 1970, pursuant to the above agreement, Reeves Rubber, Inc. paid appellant \$5,450 per month for "salary, rent, or retirement pay." In 1967, however, appellant sold the California real property which the corporation had been renting, and, in 1970, the new owners denied the corporation further access to or use of the property. Consequently, beginning in November 1970, the corporation withheld \$1,950 from the monthly payments to appellant.

Appellant was a resident of California at the time of the execution of the 1958 settlement agreement. The record on appeal indicates that appellant and his wife moved to and became residents of Nevada prior to 1967. The record also indicates that appellant performed no "advisory and **consultive**" services for the corporation subsequent to 1967.

On December 22, 1972, an "Agreement and Settlement of All Outstanding Claims" was reached by appellant and Reeves Rubber, Inc. Pursuant to the agreement, the **corporation** paid appellant **\$47,775**, representing "disputed past due rent" for the period from November 1970 to November 1972. The corporation also agreed to give appellant its promissory note for \$400,000. The agreement allocated \$50,000 of the note to the purchase of appellant's stock interest in the corporation, and \$350,000 of the note to the "full settlement of all disputes between the parties and in full satisfaction of all claims."

Appellant filed a 1970 nonresident California personal income tax **return**, but did not file California **returns** for the years 1971 and 1972. On the 1970 return, appellant did not report the payments received from Reeves Rubber, Inc. during that year as income subject to California taxation. The proposed assessments which gave rise to this appeal were issued by respondent on the basis of its determination that the monthly payments made to appellant by Reeves Rubber, Inc. during 1970, 1971, and 1972, as well as the \$47,775 and \$350,000 payments of 1972, are taxable by California pursuant to section 17041 of the Revenue and Taxation Code. 1/

1/ Respondent did not include the \$50,000 payment for appellant's **stock** interest in Reeves Rubber, Inc. in its calculation of appellant's California source income. (See Robinson v. McColgan, 17 Cal. 2d 423 [110 P. 2d 426] (1941).)

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Section 17041 provides that the California personal income tax "shall be **imposed...** upon the entire taxable income of every nonresident which is derived from sources within this state." (Emphasis added.) In challenging assessments issued under this provision, the taxpayer bears the burden of proving that the income in question was not derived from sources within this state. (See Appeal of Robert L. Webber, Cal. St. Bd. Of Equal., October 6, 1976.) For the reasons indicated below, it is our opinion that appellant has not sustained his burden of proving that the payments received from Reeves Rubber, Inc. during the years 1970, 1971, and 1972 were not derived from sources within this state.

The 1958 settlement agreement refers to the \$5,450 monthly payments as "salary, rent, or retirement pay," and the 1972 agreement attributes the \$47,775 payment to "disputed past due rent." yet, during the years 1970, 1971, and 1972, appellant performed no services for the corporation and he owned no real property which was being rented to the corporation. The 1958 agreement also provides for appellant's covenant not to **compete** with the corporation in the seven southern counties of California and for appellant's transfer and assignment of patent rights and trade formulas to the corporation. Under the circumstances, and in light of appellant's failure to submit any information regarding the nature of the underlying claims on which the 1958 settlement was based, we must assume that the payments in question, including the \$350,000 payment made in 1972, were **intended to provide appellant with a retirement pension** and to compensate appellant for the covenant not to compete and the transfer of patent rights and trade **formulas**.

In the recent Appeal of John J. and Virginia Baustian, decided March 7, 1979, this board held that retirement income paid to a nonresident constituted income derived from sources within this state where such income was directly attributable to personal services performed by the taxpayer while a resident of this state. With respect to the **instant appeal**, to the extent that the payments in question represent retirement income, such payments are directly attributable to personal services performed by appellant as an officer of Reeves Rubber, Inc. while he was a resident of this state. Accordingly, on the basis of our decision in Baustian, and for the reasons stated therein, we conclude that the retirement **income** received by appellant during the years 1970, 1971, and 1972 constituted income derived from sources within this state. 2/

2/ Contrary to appellant's contention, section 17596 of the Revenue and Taxation Code has no bearing on the issue presented by this appeal. As we indicated in Baustian, the provisions of that section are not applicable with respect to income of a nonresident which accrues subsequent to a change in residency status.

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Appellant has failed to present any argument **concern-**ing the "source" of payments made in connection with a covenant not to compete or a transfer of patent rights and trade formulas. Respondent's regulations provide, in pertinent part:

Income from sources within this State includes. ..rentals or royalties for the use of, or for the privilege of using in this State, patents, copyrights, secret processes and formulas, good will,. . .and other like property having a taxable or business **situs** in this State. (Cal. Admin. Code, tit. 18, reg. **17951-17954(b).**)

On the basis of respondent's regulations, and in the absence of any evidence or argument to the contrary, we must conclude that the payments made to appellant to compensate him for the covenant not to compete and the transfer of patent rights and trade formulas constitute income derived from sources within this state. (See Cal. Admin. Code, tit. 18, reg. **17951-17954(f)**, subd. (3); Korfund Co., 1 T.C. 1180, 1187 (**1943**).)

For the reasons stated, we conclude that the payments made to appellant by Reeves Rubber, Inc. during 1970, 1971, and 1972 are taxable by California under section 17041 as income derived from sources within this state. Therefore, respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Ray R. and Nellie A. Reeves against proposed assessments of additional personal income tax in the amounts of **\$3,027.00**, **\$2,510.00**, and **\$38,123.30** for the years 1970, 1971, and 1972, respectively, be a:nd the same is hereby sustained.

Done at Sacramento, California, this 28th day of
June , 1979, by the State Board of Equalization.

William B. Bennett Chairman
Paul D. [unclear] Member
Robert [unclear] Member

_____ Member